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Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of human rights, particularly economic, social and cultural rights

Note by the Secretariat

The Secretariat has the honour to transmit to the Human Rights Council the thematic report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Juan Pablo Bohoslavsky, prepared pursuant to Council resolution 25/16.

In the report, the Independent Expert explores the interrelationships between income and wealth inequality, on the one hand, and financial crises, on the other, and their implications for the enjoyment of human rights. He illustrates how increased levels of such inequalities may contribute to increases in sovereign debt that may subsequently degenerate into financial crises. Furthermore, he examines the reverse relationship by assessing the distributional impact of financial crises and points to severe adverse effects on the enjoyment of human rights. He concludes with a set of policy recommendations designed to target economic inequality as a pressing human rights issue and a factor contributing to the emergence of financial crises.

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Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of human rights, particularly economic, social and cultural rights

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I. Introduction

1. Severe economic inequality frequently affects the enjoyment of particular civil, political or social, economic and cultural rights as well as the principle of non-discrimination enshrined in all international human rights treaties. Human rights law imposes certain legal obligations on States to address economic inequalities affecting the enjoyment of human rights and bestows effectual guidance for reducing inequalities, including prioritization of policy responses in this field. Human rights mechanisms have therefore recently paid increased attention to economic inequality and human rights.[1]

2. Furthermore, a better understanding of the negative effects of increased economic inequality on social development has recently emerged. For example, States have made reducing inequality within and among countries Goal 10 of the Sustainable Development Goals, which includes not only the promotion of the social, economic and political inclusion of all, irrespective of age, sex, disability, race, ethnicity, origin, religion or economic or other status, but also the adoption of fiscal, wage and social policies to progressively achieve greater equality and better regulation of global financial markets and institutions.

3. Yet, there is one particular facet of inequality that has been frequently neglected: the linkages among economic inequality, financial crises and human rights. There is widespread acknowledgement that financial crises and adjustment programmes adopted in their response not only impair a country's general economic performance, but also frequently increase inequality and have a negative impact on socioeconomic outcomes and particularly on vulnerable populations. However, the notion that inequality may also be an important contributing factor to the emergence of financial crises has only recently gained wider attention. In the present report, the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, will offer reflections on both dimensions, exploring answers to the following questions: does inequality lead to more financial instability? Does financial instability lead to higher levels of inequality? What are the impacts on human rights of increased inequality? And, finally, what guidance does human rights law provide for addressing inequality?

4. In so doing, the report will be exclusively devoted to the relationship between human rights and economic inequality, and specifically income and wealth inequality. Hence, the term "inequality" employed in the report, unless otherwise qualified, should be understood as referring to these types of inequality.[2]

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[1] See, for example, the report of the Special Rapporteur on extreme poverty and human rights (A/HRC/29/31).

[2] Moreover, while both income and wealth inequality relate to economic disparities, there are important differences between the two aspects. Inequality in wealth appears to be more pronounced in many countries and in the world generally. Policy responses designed to address wealth inequality on the one hand and income inequality on the other hand may differ. Therefore, the report clearly distinguishes between those two forms of inequality where necessary. However, if such distinction is not expressly made, then the term "inequality" encompasses both forms of economic inequality.

II. Why must inequality be considered from a human rights perspective?

5. For several years, increased attention has been paid to the continued rise in income and wealth inequalities. In this context, top incomes dramatically increased from the 1980s, mostly in developed countries but also in emerging economies, such as India and China.[3] In addition to wealth transmitted through inheritance, top wages have increased dramatically, outpacing increases in average wages many times and resulting in an unprecedented accumulation of wealth by a small but powerful elite.[4]

6. Global inequality currently stands at extremely high levels and is further increasing. The United Nations Development Programme (UNDP) has reported that the richest 8 per cent of the world's population earns half of the world's total income, leaving the other half for the remaining 92 per cent.[5] Over the past two decades, income inequality has increased by 9 per cent in developed countries and 11 per cent in developing countries.[6] In 2015, the richest 1 per cent of people in the world owned more than 50 per cent of global wealth, up from 44 per cent in 2010.[7] Furthermore, the 80 richest individuals currently own as much wealth as the bottom 50 per cent of the entire global population.[8]

7. International human rights law addresses inequality on many levels. First, there are economic and social rights that clearly recognize the duties of States to address and/or prevent inequality as a threat to human rights realization. These include fundamental worker's rights — in particular the right to form and join trade unions and the right to fair remuneration — and social rights — in particular the rights to education, health and social security.[9]

8. Moreover, the principles of non-discrimination and equality apply in the context of socioeconomic disadvantages. All international and regional human rights treaties include a broadly constructed principle of non-discrimination,[10] that covers formal discrimination on prohibited grounds in law or official policy documents as well as substantive discrimination, meaning discrimination in practice and in outcomes. For example, States have certain obligations to ensure equal access to health services, adequate housing and water and sanitation.[11] The prohibition of discrimination extends not only to the grounds explicitly enumerated in article 2 (2) of the International Covenant on Economic, Social and Cultural Rights, such as race, colour, sex or religion, but also to grounds based exclusively on economic and social status.[12]

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[3] See A.B. Atkinson, T. Piketty and E. Saez, "Top income in the long run history", *Journal of Economic Literature*, vol. 49, No. 1, pp. 3-71.

[4] See T. Piketty, *Capital in the Twenty-First Century* (Cambridge, Massachusetts, Harvard University Press, 2014).

[5] See UNDP, *Humanity Divided: Confronting Inequality in Developing Countries* (New York, 2013).

[6] Ibid., p. 7, using the Gini coefficient.

[7] See "Global wealth report", Credit Suisse Research Institute, pp. 19 and 21 (2015).

[8] See "Wealth: having it all and wanting more", Oxfam issue briefing, pp. 2 and 3 (2015).

[9] See Committee on Economic, Social and Cultural Rights, general comments No. 13, para. 6 (b) (iii); No. 14, para. 19; and No. 19, paras. 16 and 25.

[10] See, for example, article 2 (1) of the International Covenant on Civil and Political Rights or article 2 (2) of the International Covenant on Economic, Social and Cultural Rights; article 14 of the European Convention for the Protection of Human Rights and Fundamental Freedoms; and article 1 (1) of the American Convention on Human Rights.

[11] See Committee on Economic, Social and Cultural Rights, general comment No. 20 (2009) on non-discrimination in economic, social and cultural rights, among other general comments.

[12] Ibid., para 35.

9. While human rights law does not necessarily imply a perfectly equal distribution of income and wealth, it does require conditions in which rights can be fully exercised. As a consequence, a certain level of distribution of resources is expected to guarantee individuals an equal enjoyment of the realization of their basic rights without resulting in discriminatory outcomes.[13] When income inequality creates discriminatory outcomes, it becomes a human rights issue. States can make an important contribution to overcoming discrimination by ensuring equal opportunity for all members of society. However, the notion of equal opportunity resembles a myth in many countries and situations, and many people in the world do not have reasonable means for overcoming socioeconomic handicaps.[14]

10. Inequality implies a violation of the rights enshrined in the Covenant when a significant number of individuals within a society cannot enjoy minimum essential levels of each of the rights enumerated in the Covenant, while other individuals within the society have more than sufficient resources available to guarantee a basic enjoyment of those rights. The violation in such cases appears to be twofold: States may fail to meet their minimum core obligations and to mobilize maximum available resources for the progressive realization of rights, as explained below.

11. According to the views of the Committee on Social, Economic and Cultural Rights, when a significant number of individuals living in a State party are deprived of critical foodstuffs, essential primary health care, basic shelter and housing or the most indispensable forms of education, there is a prima facie case of failing to discharge its obligations under the Covenant.[15] It should be noted that the minimum income necessary for the enjoyment of such essential levels of economic, social and cultural rights may differ from one individual to the other — an aged and sick person may potentially need more resources to enjoy effective access to adequate health care and medication than a healthy young person — and from one country to the other. In essence, international human rights norms require States to ensure that all persons residing in their territory live in conditions of dignity.

12. States are furthermore obliged to use maximum available resources for the progressive realization of economic, social and cultural rights. Progressive realization implies that States have to ensure the enjoyment of minimum essential levels of rights on a non-discriminatory basis first and without retrogression. It is the view of the Independent Expert that States may also fail to use their maximum available resources if they neglect to undertake reasonable efforts to ensure domestic revenue generation and redistribution to address income inequality that violates human rights, such as if a State fails to address inequality through appropriate taxation or social policies.[16]

13. To reduce the concept of "maximum available resources" to only those resources on the balance sheet of the treasury would be contrary to the purpose of the Covenant and the Universal Declaration of Human Rights, which guarantees to every person a life in dignity and freedom from fear and want. Maximum available resources also encompass those

[13] See R. Balakrishnan, J. Heintz and D. Elson, "What does inequality have to do with human rights?", Political Economy Research Institute, Working Paper Series No. 392 (2015), p. 16.

[14] J.E. Stiglitz, *The Price of Inequality: How Today's Divided Society Endangers Our Future* (New York, W.W. Norton and Company, 2012), p. 18.

[15] See Committee on Economic, Social and Cultural Rights, general comment No. 3 on the nature of States parties' obligations, para. 10.

[16] See "Política fiscal y derechos humanos en las Américas: movilizar los recursos para garantizar los derechos", thematic report submitted by civil society organizations to the Inter-American Commission on Human Rights, October 2015. Available in Spanish from www.cesr.org/downloads/cidh_fiscalidad_ddhh_oct2015.pdf.

resources that a State can reasonably generate through adequate, appropriate and fair taxation of individuals and corporations or through the levying of tariffs.

14. In addition, it should be noted that article 2 (1) of the Covenant explicitly refers to those resources that can be made available through international assistance and cooperation, in particular economic and technical assistance. It also extends to an obligation to create an international enabling environment conducive to the universal fulfilment of human rights. This international terrain includes bilateral and multilateral trade, investment, taxation, finance, environmental protection and development cooperation. In other words, human rights law requires a certain degree of redistribution of resources and support based on available capacities within and among nations. This encompasses an organization of the local and global economies that prevents and eradicates extreme poverty.[17] Violations of this principle are pervasive: With 795 million people worldwide being undernourished, at least one out of nine persons on Earth is currently excluded from enjoying essential minimum levels of the right to food.[18] The United Nations Human Settlements Programme has estimated that close to one billion people currently do not have adequate housing but instead often live in informal settlements in developing countries.[19] Inequalities within and among nations are an important contributing factor to these unsettling outcomes. Inequality is both a cause and a symptom of massive violations of economic, social and cultural rights.

15. Economic inequality also matters from a human rights perspective when it translates into other types of inequalities. The enjoyment of human rights does not depend only on access to goods and services reflecting the minimum needed for survival; an individual's access to resources relative to others is also of crucial importance. Data suggests that high levels of relative inequality may have substantial negative effects on the practice of human rights. It has been observed that low-income households in a very unequal society may do worse than households with the identical income in a more equal society.[20] This pattern is obvious in numerous areas, including legal representation, education, political influence, health, housing and social discrimination that can escalate into conflict.

16. To illustrate, a poor domestic worker may not be able to sue his or her employer to challenge an unfair unilaterally imposed pay cut, both because labour rights may not be institutionalized in the State and because legal representation is not affordable. Continuing to work in unfair conditions or quitting the job may be the only viable options, which is a choice that can beget oppression, particularly when market conditions of high unemployment make replacing employees rather easy.

17. Likewise, people in poverty may not be able to afford higher education because of prohibitively high tuition fees, the need to work for immediate income and the inability to

[17] See principle 29 of the Maastricht Principles on Extraterritorial Obligations of States in the Area of Economic, Social and Cultural Rights.

[18] See Food and Agriculture Organization of the United Nations (FAO), *The State of Food Insecurity in the World. Meeting the 2015 international hunger targets: taking stock of uneven progress* (Rome, 2015), p. 8. FAO employs a narrow definition of undernourishment, which has faced heavy criticism for masking the magnitude of the hunger problem, see F.M. Lappé et al., "How we count hunger matters", Ethics and International Affairs, vol. 27 No. 3 (2013), pp. 251-259.

[19] See http://mirror.unhabitat.org/content.asp?cid=11848&catid=746&typeid=24&subMenuId=0.

[20] See R. Balakrishnan, J. Heintz and D. Elson, "What does inequality have to do with human rights?", Political Economy Research Institute, Working Paper Series No. 392 (2015). See also R. Wilkinson and K. Pickett, *The Spirit Level: Why More Equality Societies Almost Always Do Better* (New York, Bloomsbury Press, 2009).

move themselves out of unskilled positions, which can also become a multigenerational trap.[21]

18. It is also common for poorer segments of the population to be marginalized or even effectively excluded from the political process. As noted by the Special Rapporteur on extreme poverty and human rights, Philip Alston, economic and social inequalities often reinforce one another "when individuals with higher incomes or their family members have more political power or access to better education than those with lower incomes".[22] In failing to recognize the connection between social and economic inequalities, there is a risk of political capture of the political system by economic elites, effectively undermining the right to vote and the principle of democracy.

19. Equally significant is that those on the high end of the income and wealth divide become less dependent on public goods and services because they have the means to purchase private alternatives. At the same time, the poor are getting more dependent on public services, as private alternatives become less affordable for them. As soon as the more affluent and powerful groups in society cease to depend on public goods and services, the State is less likely investing in public, collective goods, leading to a vicious circle of their degeneration.

20. Moreover, countries suffering from high levels of inequality have worse health outcomes compared to other countries with a similar gross domestic product (GDP).[23] For example, there is a strong positive correlation between rates of child mortality and inequality among countries at similar levels of development. Also, inequality may impair the availability of adequate housing for low-income households.[24]

21. Inequality often contributes to social exclusion and marginalization of certain groups and individuals. In addition, if inequality entrenches social cleavages along regional, religious, racial or ethnic lines, social instability and violent internal conflict are more frequent.[25] It has recently been noted that "[w]hen the poor are from one race, ethnicity, religion or region and the rich are from another, a lethal, destabilizing dynamic often emerges".[26] Inequality not only increases the risk of economic and social rights violations, but also augments the likelihood of severe violations of civil and political rights.[27]

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[21] For more information on the negative effect of income inequality on the right to education, see the report of the Special Rapporteur on extreme poverty and human rights (A/HRC/29/31, para. 30).

[22] Ibid., para. 6.

[23] See R. Wilkinson and K. Pickett, *The Spirit Level: Why More Equality Societies Almost Always Do Better* (New York, Bloomsbury Press, 2009).

[24] See J. Matlack and J. Vigor, "Do rising tides lift all prices? Income inequality and housing affordability", *Journal of Housing Economics*, vol. 17, No. 3 (2008), pp. 212-224.

[25] See L.E. Cederman, N.B. Weidmann and K. Skrede Gleditsch, "Horizontal inequalities and ethnonationalist civil war: a global comparison", *American Political Science Review*, vol. 105, No. 3 (2011), pp. 487-89.

[26] See M.W. Doyle and J.E. Stiglitz, "Eliminating extreme inequality: a sustainable development goal, 2015-2030", *Ethics and International Affairs*, vol. 28, No. 1 (2014).

[27] See T. Landman and M. Larizza, "Inequality and human rights: who controls what, when, and how", *International Studies Quarterly*, vol. 53, No. 3 (2009), pp. 715-736.

III. Addressing central questions: how do inequality and debt crises interact?[28]

A. Inequality as a source of sovereign debt increase and crisis

22. Inequality may affect sovereign debt both directly and indirectly. In short, the direct impact proceeds from the "corrosive" influence of inequality on the tax base, as well as from its enhancing effect on demand for redistribution through debt default. As for the indirect impact, it is mainly private debt that acts as an interface between inequality and sovereign debt. Increasing inequality may lead to private overborrowing and overlending. The resulting excessive private leverage can accumulate over many years, destabilize the financial system[29] and even become so volatile for the economy that the debt can trigger a banking crisis, leading to both output losses and massive bailout costs for Governments. In addition, both the direct and the indirect channel may simultaneously prompt a currency crisis if external debt is involved.

1. Inequality as a direct cause of sovereign debt increase and financial crises

23. Inequality may exert a considerable direct influence on the structure and the level of government revenues and spending. Increased levels of inequality also mean that the income tax base of the State concerned is rather small, at least if income taxation is not progressive. This diminishes sovereign revenues and consequently makes the State more dependent on borrowing. Thus inequality contributes in many cases to sovereign debt, which may eventually result in sovereign default and financial crises. There is a growing body of evidence for this mechanism.

24. Empirical studies point to a clear nexus between inequality, income tax base and sovereign debt. One study, using data from 50 countries in 2007, 2009 and 2011, found a negative correlation between income inequality and the tax base and a positive correlation with sovereign debt.[30] An analysis of a panel of 17 countries of the Organization for Economic Cooperation and Development (OECD) covering the period 1974-2005 found a positive correlation between the top 1 per cent income share, a widely used indicator of income inequality, and fiscal deficit.[31] The erosion of the income tax base following an increase in inequality is also likely to affect the structure of tax revenue. The alternative to experiencing a fiscal deficit would be to increase other types of taxes, such as import or export duties and indirect or corporate taxes. This would, however, lead to higher revenue volatility, consequently increasing the risk of sovereign debt crisis.

25. Increased inequality is also found to contribute to the degeneration of sovereign debt into sovereign debt crises. A number of studies show that high inequality increases the

[28] For a detailed overview of the interrelationships between inequality and financial crises, see R. Bazillier and J. Hericourt in "The circular relationship between inequality, leverage and financial crisis", Laboratoire d'Economie d'Orléans, (University of Orleans, 2015). The Independent Expert wishes to thank the authors of that article for having prepared a background research paper for the present report.

[29] See M. Kumhof, R. Ranciere and P. Winant, "Inequality, leverage and crises", *American Economic Review*, vol. 105, No. 3 (2015), pp. 1217-1245.

[30] See J. Atzenman and Y. Jinjarak, "Income Inequality, Tax Base and Sovereign Spreads", *FinanzArchiv: Public Finance Analysis*, vol. 68, No. 4 (2012), pp. 431-444.

[31] See S. Milasi, "Top income shares and budget deficits", Centre for Economic and International Studies, Research Paper Series, vol. 10, issue 11, No. 249 (August 2013).

probability of default significantly.[32] In one research paper, it was emphasized that sudden, rapid rises in inequality, in particular, can considerably increase the sovereign default risk. The authors specify that such "inequality shocks" generate a far higher probability of default than collapses of domestic production of the same scale.[33] Several authors have also established that progressive income taxes, which decrease income inequality, can decrease the default risk.[34]

26. One explanation for these links focuses on the incentives of the government to reap the short-term gains of a default. By defaulting, the government may obtain new fiscal freedom — even if this freedom might be short-lived — permitting tax cuts or spending increases to the benefit of the poorer. These benefits are considered greater in more unequal societies with a larger number of low-income households.[35] At the same time, owing to the higher probability that a government in highly unequal States may decide to default, lenders may accept only lower levels of aggregate debt before they sharply raise interest rates or even refuse to issue further credit.[36] According to some authors, the levels of debt lenders deem acceptable differ for domestic and foreign debt, the letter being decidedly lower.[37] This indicates that external debt is per se an important factor that may cause sovereign default.

27. Yet, in the long run, default normally implies future costs owing to a (temporary) exclusion from financial markets. As the government cannot use any more debt to smooth taxes, it is forced to adjust its tax revenues to any short-term fluctuation. The resulting volatile taxation harms poorer households in particular. The more numerous they are, the larger the future costs of default therefore become. However, the incentives to default tend to dominate the second in very unequal societies; hence, economies with more progressive taxation have less incentive to default.

2. Inequality as an indirect cause of sovereign debt increase and financial crises

28. Inequality can also indirectly contribute to increased sovereign debt and consequently to sovereign debt crises. There are at least two avenues to such outcomes: (a) high levels of inequality contribute significantly to the generation and increase of private debt, with strong interrelationships between excessive private debt, sovereign debt and financial crises; and (b) inequality adversely affects social and political stability, thereby hampering growth and eventually affecting both government revenue and spending.

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[32] See A. Berg and J. Sachs, "The debt crisis structural explanations of country performance", *Journal of Development Economics*, vol. 29, No. 3 (1988), pp. 271-306; J. Sachs, "The debt overhang of developing countries", *Debt, Stabilization and Development: Essays in Memory of Carlos Diaz Alejandro* (Oxford, 1989) and the papers referred to in footnotes 33-37.

[33] See K. Jeon and Z. Kabukcuoglu, "Income inequality and sovereign default", working paper (University of Pittsburgh, 2015).

[34] Ibid.; see also A. Ferriere, "Sovereign default, inequality and progressive taxation", job market paper (New York University, 2014).

[35] See A. Ferriere, ibid.; and Y.K. Kim, "Inequality and sovereign default under democracy", *European Journal of Economic and Political Studies*, vol. 6, No. 1 (2013), pp. 5-40. It is important to note that a default does not imply per se negative consequences for the population. It is mainly the fiscal retrenchment following the default — because the government cannot anymore borrow on financial markets — which impacts negatively the people's human rights.

[36] See A. Dovis, M. Golosov and A. Shourideh, "Political economy of sovereign debt: cycles of debt crisis and inequality overhang", mimeo (2015).

[37] See C.M. Reinhart, K.S. Rogoff and M.A. Savastano, "Debt intolerance", *Brookings Papers on Economic Activity*, vol. 34, No. 1 (Brookings Institution, 2003), pp. 1-74.

Interrelationships between private debt, sovereign debt and financial crises

29. A boom in private debt is usually considered a more accurate predictor of financial instability than the level or development of sovereign debt.[38] However, sovereign debt may be, depending on the circumstances, a major factor for triggering or worsening financial crisis. For example, excessive sovereign debt in some countries has been a prominent contributor to the recent global financial crisis. Public and private debts are linked in many ways, often reinforcing the other's negative effects, which may be described as a diabolical loop between both.[39] Even when financial crises are not necessarily driven by public debt, such debt has an impact on the aftermath of crises, leading to more prolonged periods of economic depression.[40]

30. The consequences of a financial crisis on public finances are immense. Nationalization of private debts along with bailout and recapitalizing costs for the banking system have contributed to an explosion of sovereign debt. Even more important factors to the aggregation of sovereign debt are generally the fall in production, the consecutive contraction in the tax base and countercyclical policies set to fight the downturn resulting in higher government spending. If the country instead uses consolidation policies to reduce its debt, this often turns out counterproductive because of a negative impact of reduced government spending on economic growth and employment, as the International Monetary Fund (IMF) has recently acknowledged.[41]

31. There are several channels through which inequality affects private debt and financial crises. As a starting point, it is noteworthy that household debt and top income share — a standard indicator of inequality — are strongly correlated: in many countries, household debt and top income share have grown simultaneously and at similar pace over many years.[42] Recent research has focused on credit demand and supply channels for explaining the nexus between private debt and inequality.

32. According to the credit-demand line of reasoning, private debt increases as households try to maintain certain absolute or relative levels of consumption, while facing growing inequality.[43] In other words, people borrow more extensively to maintain their absolute or relative standard of living. Data collected for the United States of America confirm this interpretation: a study from 2006 revealed that, over the previous 25 years, income inequalities in the United States had increased without being followed by an increase in consumption inequalities.[44] Some explain this as a result of a higher dispersion of transitory income, but it appears likely that massive permanent income shifts play a more

[38] See M. Schularik and A.M. Taylor, "Credit booms gone bust: monetary policy, leverage cycles and financial crises, 1870-2008", *American Economic Review*, vol. 102, No. 2 (2012), pp. 1029-1061.

[39] See M. Brunnermeier et al, "European Safe Bonds" (Euro-nomics group, 2011).

[40] See O. Jorda, M. Schularick and A.M. Taylor, "Sovereigns versus banks: credit, crises and consequences", working paper No. 19506 (National Bureau of Economic Research, 2013).

[41] See IMF, *World Economic Outlook 2012: Coping with High Debt and Sluggish Growth*, World Economic and Financial Surveys (Washington, D.C., 2012); and N. Batini, L. Eyraud, L. Forni and A. Weber, "Fiscal multipliers: size, determinants and use in macroeconomic projections", IMF technical notes and manuals No. 14) (Washington, D.C., 2014).

[42] See Bazillier and Hericourt, "The circular relationship between inequality, leverage and financial crisis" (footnote 28).

[43] See J.K. Galbraith, *Inequality and Instability, A Study of the World Economy Just Before the Great Crisis* (Oxford, 2012).

[44] See D. Krueger and F. Peri, "Does income inequality lead to consumption inequality? Evidence and theory", *Review of Economic Studies*, vol. 73, No. 1 (2006), pp. 163-193.

prominent role here.[45] In particular, the observation that the debt-to-income ratio of the top 5 per cent and bottom 95 per cent households has undergone a dramatic reversion between 1983 and 2007 supports the latter view.[29] Also, a negative link between income inequality and social mobility was found by analysing a sample of 16 countries.[46] For numerous developing and developed countries, it has also been shown that the increase in inequality was mainly due to an increase in between-group inequality, reflecting permanent income shocks.[47] Explanations for persistent borrowing by low- and middle-income households despite growing income inequality can be found in several variants of the relative income hypothesis, according to which household consumption is a function of the household's position in the income distribution and its past levels of consumption.[48]

33. Another theory connects inequality, credit demand and monetary policy. It holds that highly unequal income distribution leads to overreliance on investment and luxury consumption. This may not be sufficient for a sustainable level of economic output, prompting low interest rates which itself allows private debt to increase beyond sustainable levels.[49]

34. In turn, the rise in the incomes of the richest will also increase their savings, leading to a huge accumulation of private wealth. This rising supply of capital requires more investment opportunities and consequently boosts the credit supply, even for riskier borrowers.[50] Moreover, a possible consequence of this accumulation of private wealth is creditor-led lobbying to favour policies that may lead banks to issue risky loans and eventually to a massive distribution of subprime loans to low income individuals. It has been argued that "growing income inequality in the United States ... led to political pressure for more housing credit", which eventually "distorted lending in the financial sector".[51]

35. It seems likely that the credit demand and credit supply channel are activated simultaneously. Other factors also play an important role.[52] A general shift towards a

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[45] See R.A. Moffitt and P. Gottschalk, "Trends in the transitory variance of male earnings in the United States, 1970-2004", working paper No. 16833 (National Bureau of Economic Research, 2011); and M. Iacoviello, "Household debt and income inequality, 1963-2003", *Journal of Money, Credit and Banking*, vol. 40, No. 5 (2008), pp. 929-965.

[46] See D. Andrews and A. Leigh, "More inequality, less social mobility", Applied Economics Letters, vol. 16, No. 15 (2009), pp. 1489-1492.

[47] Ibid; see also R. Kanbur, C. Rhee and J. Zhuang, "Rising inequality in Asia and policy implications", macroeconomics working paper No. 23973 (East Asian Bureau of Economic Research, 2014).

[48] See T. van Treeck, "Did inequality cause the United States financial crisis?", *Journal of Economic Survey*, vol. 28 No. 3 (2014), pp. 421-448; and R.H. Frank, A.S. Levine and O. Dijk, "Expenditure cascades", *Review of Behavioral Economics*, vol. 1, Nos. 1 and 2 (2014), pp. 55-73.

[49] See J.-P. Fitousso and F. Saraceno, "How deep is a crisis? Policy responses and structural factors behind diverging performances", working document No. 2009-31 (Observatoire français des conjonctures économiques, 2009); and A.B. Atkinson and S. Morelli, "Economic crises and inequality", Human Development Research Paper No. 2011/06, (United Nations Development Programme, 2011).

[50] See P. Lysandrou, "Global inequality, wealth concentration and the subprime crisis: a Marxian commodity theory analysis", *Development and Change*, vol. 42, No. 1 (2011), pp. 183-208. See also M. Kumhof et al, "Inequality, leverage and crises" (footnote 29).

[51] See R.G. Rajan, Fault Lines: How hidden fractures still threaten the world economy, (Princeton, 2010); see also Galbraith, *Inequality and Instability* (footnote 43).

[52] See Bazillier and Hericourt, "The circular relationship between inequality, leverage and financial crisis" (footnote 28).

radical free-market stance,[53] the prevalent finance-led model of growth and the accompanying deregulation of the financial sector even seem to be main factors explaining the global financial and economic crises that began in 2007, which is often labelled the "Great Recession".[54] The decline of workers' bargaining power owing to labour market flexibility and wage moderation has possibly contributed to the demand side described above. Financial liberalization and deregulation explain, besides the growing wealth at the top, increased credit supply.[55]

36. Based on the theoretical considerations above, it is not surprising that an examination of 18 OECD countries over the period 1970-2007 revealed a positive link between income inequality and credit growth.[56] Moreover, over the period 1980-2010, a large majority of banking crises were preceded by persistently high levels of income inequality.[57] Concerning the United States specifically, one study that investigated the period 1980-2003 found a "strong positive effect of income inequality in household debt relative to disposable income as well as the components of the household debt (mortgage debt, revolving debt, e.g. credit cards, and non-revolving debts, e.g. car loans)".[58] Although these results seem to confirm the theoretical ideas above, it should be noted that more empirical research is needed.

Impact of inequalities on social and political stability and growth

37. Inequality may also reduce social and political stability. This creates disincentives for investment, disruptions in business activity, disunity,[59] threats to property and policy uncertainty and may even raise the probability of coups and mass violence. The result is a lower level of growth, which consequently provokes higher level of debt. The link between inequality, political instability and investment has been confirmed by an empirical study made on 70 countries over the period 1960-1985.[60]

38. Recent cross-country evidence supports the notion that inequality reduces economic growth. Based on vast data for both OECD and emerging countries, an IMF study from

[53] See P. Krugman, "Inequality and Crises", New York Times blog "The Conscience of a liberal", (June 2010), http://krugman.blogs.nytimes.com/2010/06/28/inequality-and-crises.

[54] See Galbraith, *Inequality and Instability* (footnote 4343. He also identifies mainly financial forces as the source of growing inequality.

[55] See P. Tridico, "Financial crisis and global imbalances: its labor market origins and the aftermath", *Cambridge Journal of Economics*, vol. 36, No. 1 (2012), pp. 17-42.

[56] See C. Perugini, J. Hölscher and S. Collie, "Inequality, credit and financial crises", *Cambridge Journal of Economics* (2015), available from http://cje.oxfordjournals.org/content/early/2015/01/05/cje.beu075.full.

[57] See G. Bellettini and F. Delbono, "Persistence of high income inequality and banking crises: 1980-2010", working paper No. 885 (University of Bologna, Department of Economics, 2013). By contrast, works by A.B. Atkinson and S. Morelli come to inconclusive results, both for increases and levels of inequalities; see "Income inequality and banking crisis: a first look", report prepared for the Global Labor Forum 2011 (International Labour Organization (ILO), Turin, 2010) and "Inequality and crises revisited", working paper No. 387 (Centre for Studies in Economics and Finance, University of Naples, 2015). They also provide for possible explanations for their outcomes, in particular the choice of inequality measures and contagion between national economies due to globalization.

[58] See M. Christen and R. Morgan, "Keeping up with the Joneses: analyzing the effect of income inequality on consumer borrowing", *Quantitative Marketing and Economics*, vol. 3, No. 2 (2005), pp. 145-173, at 148.

[59] See K.H. Park, "Income inequality and economic progress: an empirical test of the institutionalist approach", *American Journal of Economics and Sociology*, vol. 55 No. 1 (1996), pp. 87-97.

[60] See A. Alesina and R. Perotti, "Income distribution, political instability, and investment", *European Economic Review*, vol. 40 No. 6 (1996), pp. 1203-1228.

2014 provides a solid case that lower inequality is robustly correlated with faster and more durable growth.[61] A further IMF study supports these conclusions using a sample of 159 advanced, emerging and developing economies. The authors conclude that the income distribution itself matters for growth. Specifically, if the income share of the top 20 per cent increases, then GDP growth actually declines over the medium term, suggesting that the benefits do not trickle down. In contrast, an increase in the income share of the bottom 20 per cent is associated with higher GDP growth.[62]

B. Impact of financial and sovereign debt crisis on inequalities

39. Financial crises generally have enormous distributional consequences, originating in several factors.

1. Decline in economic output

40. To start with, financial crises may massively hamper economic growth, principally because of decline in investment in production, as a result of credit contraction. Banking crises usually lead to a significant output drop. On average, the real per capita GDP drop amounts to over 9 per cent, with a recovery time of two years.[63] An analysis of financial crises, taking into account both banking and currency crises, has revealed that the average output loss is 20 per cent of GDP, with a recovery time of three to four years.[64] However, isolated currency crises as such may have mixed effects: they usually increase the price of imported goods and may lead to a contraction of available credit, considerably encumbering growth. At the same time, currency crises may also benefit the exporting sector of a country.

41. The consequences of sovereign-debt crisis on economic growth are difficult to isolate, as they are generally preceded by or coincide with banking crises. However, there is a strong negative correlation between extreme levels of sovereign debt or sovereign default on the one hand and growth on the other. One study, for example, has found that debt crises lead to significant and long-lasting output losses, reducing output by about 10 per cent after eight years.[65]

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[61] See J. Ostry, J. Berg and C.G. Tsangarides, "Redistribution, inequality and growth", IMF staff discussion note No. 14/02 (2014).

[62] See E. Dabla-Norris et al, "Causes and consequences of income inequality: a global perspective", IMF staff discussion note No. 15/13 (2015).

[63] See C.M. Reinhart and K.S. Rogoff, "The aftermath of financial crises", *American Economic Review*, vol. 99 No. 2 (2009), pp. 466-72.

[64] See M.D. Bordo et al, "Is the crisis problem growing more severe?", *Economic Policy* Vvl. 16 No. 32 (2001), pp. 51-82. The authors also demonstrate that banking and currency crises have become more frequent in the last quarter of the twentieth century.

[65] See D. Furceri and A. Zdzienicka, "How costly are debt crises?", *Journal of International Money and Finance*, vol. 31, No. 4 (2012), pp. 726-742; see also F. Sturzenegger, "Toolkit for the analysis of debt problems", *Journal of Restructuring Finance*, vol. 1 No. 1 (2004), pp. 201-03; and B. De Paoli, and G. Hoggarth, "Costs of sovereign default", *Bank of England Quarterly Bulletin*, (Q3, 2006), finding negative correlations between sovereign default and growth. Although some researchers interpret sovereign default as the beginning of economic recovery, for example, E. Levy Yeyati and U. Panizza, "The elusive costs of sovereign defaults", *Journal of Development Economics*, vol. 94 No. 1 (2011), pp. 95-105, this does not contradict the finding that high increasing levels of sovereign debt may hamper economic growth, as "the anticipation of a default causes low growth", *ibid.*

2. Inflation, unemployment and labour share

42. In addition to this slowdown in economic activity, there are several other channels through which financial crises affect income and wealth distribution. Currency crises exert their influence by leading to relative price changes, fiscal retrenchment and changes in assets.[66] Devaluation leads to the aforementioned fall in earnings of those employed in the non-tradable sector, while it increases the demand for exports and therefore may benefit employment and earnings in this sector. The poor may also be affected by the price increase of imported goods, especially food prices. Fiscal retrenchment and public spending cuts may affect social assistance outlays, amplifying the consequences of the crisis on the poor. Lastly, changes in the value of assets have an impact on income distribution because variations in interest rates, assets and real estate prices are more likely to affect the wealth of the better off.

43. In the aftermath of banking crises, the associated unemployment rate rises on average by about 7 percentage points, with a duration of over four years.[67] Currency crises also affect the labour share of income.[68] The labour share is a key indicator for the distribution of income in a country: it shows how much of national income is distributed to labour and how much to capital. Currency crises are associated with a strong fall of the labour share, which is only partially compensated in the following years. Even the long-term trend of declining labour share that has been observed for decades may at least partly be explained by financial crises. This implies consistently growing income inequality, as a falling labour share means that an ever larger share of the benefits of growth accrues to owners of capital. This development may be even more significant in developing countries, where a large share of the capital is held by foreigners.[69]

3. Growth in poverty

44. In total, currency crises have a magnifying impact on both the spread of poverty and inequality. Based on the Gini coefficient, one particular study found inequality to increase by 0.63 per cent relative to the pre-crisis year. Moreover, the association between crises and income distribution/poverty was stronger when crises were followed by average income losses. This fall of income accounted for 15-30 per cent of the variations in the poverty and inequality indicators. The study also found a more-than-proportional fall in the income share of the lowest income quintiles and an increase in the income share of the highest quintile.[70] Another study concluded that on the average inequality rises by 16.2 per cent in the two-year period immediately following a currency crisis as opposed to 3.2 per cent in years without crises.[71] The Great Recession, best described as a systemic banking crisis, which has been followed by a debt crisis, especially in the European Union, has led to

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[66] See E. Baldacci, L. de Mello and G. Inchauste, "Financial crises, poverty and income distribution", IMF working paper No. 02/4 (2002).

[67] See C.M. Reinhart and K.S. Rogoff, "The aftermath of financial crises", *American Economic Review*, vol. 99 No. 2 (2009), pp. 466-72.

[68] See R. Bazillier and B. Najman, "Labour and Financial Crises: Is Labour paying the price of the crisis?", mimeo (2012).

[69] See I. Diwan, "Debt as sweat: labor, financial crises, and the globalization of capital", mimeo (Washington, D.C., World Bank, 2001); and P. Maarek and E. Orgiazzi, "Currency crises and the labor share", *Economica* vol. 80, No. 319 (2013), pp. 566-588.

[70] See Baldacci et al, "Financial crises, poverty and income distribution", (footnote 66).

[71] See J.K. Galbraith and L. Jiaquing, "Inequality and financial crises: some early findings", working paper No. 9 (University of Texas, 1999), using the Theil Index, another inequality indicator.

massive inequality jumps. Using the ratio 90 to 10 as a proxy of inequality, United States income inequalities have risen by 11 per cent between 2007 and 2011.[72]

45. When assessing the impact of financial crises on inequality, it is necessary to keep two aspects in mind that may lead to distortions of the outcomes. First, poverty rates may only be a limited indicator of the scope of the problem, as the number of people falling into poverty and escaping poverty over the same period may surge, increasing the depth of poverty, while the poverty rate remains stable. Second, top income earners may experience a decrease of their revenues in the short run owing to a crisis because of their higher dependence on capital income. This may explain why the distributional effect of crises is not always clear in the very short run.

4. Structural factors mitigating social impacts, labour regulations and safety nets

46. However, other factors have significant influence on the size of the effects of financial crises. For example, it appears that crises raise inequalities more in the most deregulated labour markets, and financial crises have had worse effects on Latin American workers than on Asians, and stronger adverse impacts on Asians than on the organized workers of Northern economies.[73] This finding suggests that there is a crucial interaction between labour market institutions and the specific effects of financial crises.

47. One should also note that the impact of crises on inequalities depends on the existing social protection system in the country, as well as the level of public spending, which serves as an automatic stabilizer during a recession. Experiences in the OECD support this notion: during the period 2007-2009, in the OECD, the household sector in the aggregate appears to have been well protected from the impact of the downturn. This was possible because of government intervention through tax and benefit systems in most countries.[74] However, consolidation policies implemented after 2010 are likely to have a greater effect on income distribution.[75]

5. Impacts of government responses to crises (fiscal consolidation)

48. In most countries, financial crisis is followed by fiscal consolidation, which may also have a strong distributional impact. Several studies on OECD countries and other emerging and advanced economies have demonstrated that fiscal consolidation is usually associated with a rise of inequalities, a fall of the labour share and a rise of long-term unemployment.[76] One study came to the conclusion that 15-20 per cent of the increase in inequality following a fiscal consolidation is explained by the rise of unemployment.[77] Social spending cuts are another substantial contributor to rising inequalities. A 1 per cent decrease in social spending is associated with a rise of 0.2-0.7 per cent in inequality.[78] Crises usually have strong effects on social spending, with lowest income countries being

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[72] See B.D. Meyer and J.X. Sullivan, "Consumption and income inequality and the great recession", *American Economic Review*, vol. 103, No. 3 (2013), pp. 178-83.

[73] Ibid., p. 7.

[74] See S.P. Jenkins et al. *The Great Recession and the Distribution of Household Income* (Oxford, Oxford University Press, 2013).

[75] Ibid.

[76] See L. Ball et al, "The distributional effects of fiscal consolidation", IMF working paper No. 13/151 (Washington, D.C., 2013); J. Woo et al, "Distributional effects of fiscal consolidation and the role of fiscal policy: what do the data say?" IMF working paper 13/195 (Washington, D.C., 2013).

[77] J. Woo et al, "Distributional effects of fiscal consolidation (footnote 76).

[78] *Ibid.*

more likely to cut social spending during crises.[79] The Great Recession, for example, has led to broad and deep cuts in social security spending.[80]

49. As to debt crises, it is challenging to disentangle the specific effects of default from those of the stabilization policies, such as those that tend to follow IMF interventions in developing countries. What seems clear is that IMF programmes are associated with a worsening of income distribution and a reduction in the incomes of the poorest citizens when external imbalances were high prior to the programme. These programmes may only decrease income inequality when external imbalances are less severe.[81]

50. Dynamics of inequalities in Latin America in the 1980s offer good insights into the potential distributive impact of debt crises. A study on this region during that decade provided strong evidence confirming that income inequality "mirrors the economic cycle, rising during recessions".[82] The costs of the crises have not been borne equally[83] and most adjustment programmes resulted in "overkill" leading to increases in poverty and inequality beyond what was necessary (and legal).[84]

6. Social impact of financial crises

51. Financial crises and the austerity measures adopted in response also have a robust negative social impact that, in turn, perpetuates or exacerbates inequality. The organization Caritas has summarized that the situation of many households in Europe "remains serious, as poverty and social exclusion are rising in most member States, affecting particularly the working age population and, consequently, children. Young people are seriously affected by labour market exclusion: nearly a quarter of economically active young people in the European Union are unemployed".[85] In a study, OECD notes that "the numbers living in households without any income from work have doubled in Greece, Ireland and Spain. Low-income groups have been hit hardest, as have young people and families with children".[86] The study also points out the adverse long-term impact of the Great Recession on families, fertility and health. Drops in fertility rates have already been observed. Families have cut back essential spending, compromising their current and future well-being. Furthermore, although it is too early to assess the overall impact on health, unemployment and connected economic difficulties are known to increase health problems, including mental illness. Cutbacks in social protection are also likely to increase health problems. As an illustration, Oxfam reports that 20 per cent of pharmacy clients in Lisbon

[79] See M. Lewis and M. Verhoeven , "Financial crises and social spending: the impact of the 2008-2009 crisis", Other Operational Studies No. 12965 (Washington, D.C., World Bank, 2010).

[80] See F. Bonnet, E. Ehmke and K. Hagemejer, "Social security in times of crisis" *International Social Security Review*, vol. 63, No. 2 (2010), pp. 47-70, at. 48.

[81] See M. Pastor, "The effects of IMF programs in the third world: debate and evidence from Latin America", *World Development*, vol. 15, No. 2 (1987), pp. 249-262; and G. Garuda, "The distributional effects of IMF programs: a cross-country analysis", *World Development*, vol. 28 No.6 (2000), pp. 1031-1051.

[82] See G. Psacharopoulos et al, "Poverty and income inequality in Latin America during the 1980s", *Review of Income and Wealth*, vol. 41 No. 3 (1995), pp. 245-264.

[83] See N. Lustig, "The 1982 debt crisis, Chiapas, NAFTA, and Mexico's poor", *Challenge*, pp. 45-50 (1995).

[84] See L. Gasparini and A. L. Lustig, "The rise and fall of income inequality in Latin America", working paper of the Center for Distributive, Labor and Social Studies (2011).

[85] "Poverty and inequality on the rise", Caritas crisis monitoring report 2015, p. 29.

[86] See OECD, *Society at a Glance 2014: OECD Social Indicators* (Paris, 2014), available from http://dx.doi.org/10.1787/soc_glance-2014-en.

did not complete their whole prescriptions owing to rising costs.[87] In a case study on Greece, Oxfam reports a strong impact of increased poverty and inequality on crime and suicide rates.[88] In Spain, meanwhile, a harsh set of austerity measures has driven a dramatic uptick in unmet health needs among the poor, wage precariousness, income inequality and poverty, especially among children.[89]

52. Similarly, several United Nations bodies have identified the social impact of debt crises and related structural adjustment programmes.[90] Studies by the United Nations Children's Fund (UNICEF) have demonstrated that debt-servicing obligations diverted cash from social welfare programmes with adverse consequences on human development.[91] Austerity measures have exacerbated the negative social impact for disadvantaged groups such as women, children, person with disabilities, older persons, people with HIV/AIDS, indigenous peoples, ethnic minorities, migrants, refugees and the unemployed, as documented in a report of the Office of the United Nations High Commissioner for Human Rights in 2013.[92] Overall, adjustment plans without consistent debt reliefs have proven to be detrimental to human development and human rights, at least in the short term. Alternatively, substantial debt relief has allowed targeted countries to scale up "poverty-reducing" expenditures.[93]

IV. Conclusions and recommendations

A. Conclusions

53. **The present report demonstrates that there are manifold linkages between inequality, private and sovereign debt and the occurrence of financial crises. Although economic research only recently has turned to this field and many aspects still need to be examined, a number of important outcomes appear to be established at this stage. First, there are strong indications that inequality may substantially contribute to and exacerbate the emergence and the course of financial crises, even if other factors, in particular financial deregulation, obviously also play a crucial role. Inequality erodes States' tax base, thereby impacting sovereign revenues. Inequality also appears to prompt increased levels of private credit, which in turn may adversely affect sovereign debt and stability of the financial markets. This phenomenon is mainly explained by rising credit demand and credit supply. Aggregate underconsumption in conjunction with corresponding low interest monetary policy may be a contributing factor to an increased credit supply.**

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[87] See T. Cavero and K. Poinsasamy, "A cautionary tale: the true cost of austerity and inequality in Europe", Oxfam briefing paper (2013).

[88] See G. Cavero, "The true cost of austerity and inequality in Europe – Greek case study", Oxfam case study (2013).

[89] See "Visualizing rights: a snapshot of relevant statistics on Spain", Centre for Economic and Social Rights fact sheet No. 14 (2015).

[90] See E/C.12/ESP/CO/5; E/C.12/GRC/CO/2; E/C.12/PRT/CO/4; A/HRC/25/Add.1; UNICEF, "Austerity measures threaten children and poor households", working paper (September 2011); UNICEF, *Children of the Recession: The impact of the economic crisis on child well-being in rich countries* (New York, 2014); and ILO, *World Social Protection Report 2014-15* (Geneva, 2014).

[91] See G.A. Cordia, R. Jolly and F. Stewart, *Adjustment with a Human Face, Vol. II*, (Clarendon Press, Oxford, 1988).

[92] E/2013/82.

[93] See A/HRC/23/37.

54. Second, according to most studies, financial crises and the subsequent policy measures commonly implemented to alleviate their consequences, for example, fiscal retrenchment and stabilization policies, enhance inequalities, with devastating social consequences. A debt crisis may have a massive depressive impact on output, which may in turn affect the level of inequality. Most studies also concur that financial crises result in an increase in income inequality. Fiscal consolidation following a sovereign debt overhang may also have strong distributional consequences, both directly and indirectly, for example, through the increase in the unemployment rate and social spending cuts. The social effects of crises, hitting in particular the most vulnerable, are often catastrophic, with widespread poverty, the emergence of health issues, rising unemployment, to name only a few common problems.

55. The report has traced the numerous social and human rights dimensions of inequality and outlined corresponding human rights obligations of States. The finding that inequality may contribute to the occurrence of financial crises, which in turn exacerbate inequality and adversely affect human rights, has far reaching policy and legal implications. It underscores that human rights, social and economic aspects are inseparably intertwined, calling for a holistic approach to preventing and confronting financial crises. The report suggests that financial crises may not be prevented without addressing the contributing human rights shortcomings, including those connected to inequality. The same is true for crisis-response measures: any reaction to financial crises that neglects the effects on human rights and inequality does not only run afoul of human rights duties and responsibilities but also risks creating the same problems again and again, preventing any economically sustainable future. This lends additional urgency to the international community's commitment to reducing inequality reflected in Goal 10 of the Sustainable Development Goals.

B. Recommendations

56. Preventing and responding to financial crises and combating inequalities must thus go hand in hand. Hence, policymakers must ensure that they tackle dangerous destabilizing developments in the financial sphere while addressing inequality directly.

1. Financial markets regulation

57. States and the international community should urgently implement financial market reforms in order to combat and prevent financial instability, excessive debt and financial crises. The current prerogatives of largely unregulated global financial markets lead to instability both within many countries and on international markets, making financial crises much more likely. They undermine accountability and endanger democratic representation. Policymakers should use a mix of tools to ensure appropriate global and domestic financial market regulation with the aim of curbing excessive credit growth. This mix should include measures of prudential regulation, debt sustainability analysis and capital controls. In order to better fulfil its guiding function for policymaking, debt sustainability analyses should incorporate inequality as a crucial factor, making sure that the debtor States are able to achieve the Sustainable Development Goals and their human rights obligations.

2. Labour policies

58. Labour market institutions provide for powerful instruments for improving pre-tax income equality and should widely be employed. States should not shy away from robust wage legislation, including introducing or raising minimum wages and

legislation to ensure equal pay between genders. Moreover, it is crucial to safeguard sufficient bargaining power of the workforce. States should thus ensure that strong collective bargaining mechanisms are in place and may be used without interference. States should also make compliance with minimum wage and work conditions a precondition for eligibility to supply goods or services to public bodies.[94] In addition, in order to sustainably combat the widening of the wealth gap States should develop and strengthen frameworks encouraging and supporting small savings.

3. Fiscal policies

59. **Inequalities can be reduced through taxation and transfers, the latter including in cash and in kind.[95] In the field of taxation, there are numerous ways for addressing inequalities.[16] To start with, it is crucial to rely more on direct than indirect taxes as the latter tend to be regressive or proportional to incomes.[96] This is particularly true for excise duties and taxes.[97]**

60. **Income taxation needs to be aligned with a number of principles. First and foremost, tax progressivity is an important factor in fostering increased equality and should therefore be a prominent guiding principle of income taxation. Trends in the most recent decades of decreasing progressivity have massively contributed to the widening of the wealth and income gap. Moreover, tax progressivity decreases the probability of financial crises and default. The top marginal income tax rate should thus be considerably higher than what is currently common.[98] The minimum taxable income must always be above the poverty line.**

61. **In general, States should take care that capital income does not receive privileged treatment compared to income from labour, as is currently prevalent in many States. Obviously, this may call for amendments to applicable tax laws, but changes in other parts of the States' legal systems may also contribute to ending the special status of capital income, as described below.**

62. **Another important step towards increased equality should be to phase out certain tax deductions and excessive and unjustified tax privileges applicable to certain sources of income and sectors. Such privileges usually benefit the high earners disproportionally and thus foil progressive taxation.**

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[94] See A. B. Atkinsons, *Inequality: What can be done?* (Cambridge, Massachusetts, Harvard University Press, 2015), pp. 147-153.

[95] See the report of the Secretary-General on the role of the United Nations in promoting a new global human order and an assessment of the implications of inequality for development (A/67/394), para. 56, in which he exhorts that governments "may wish to consider a combination of progressive income taxes and highly redistributive transfers to decrease income inequality and its impact on social development".

[96] See "Fiscal policy and income", IMF policy paper (January 2014), p. 18; C. O'Donoaghue, M. Baldini, and D. Mantovani, "Modelling the redistributive impact of indirect taxes in Europe: an application of EUROMOD", Euromod working paper No. EM7/01 (Colchester, University of Essex, 2004); and S. Cnossen, *Theory and Practice of Excise Taxation: Smoking, Drinking, Gambling, Polluting, and Driving* (Oxford, Oxford University Press, 2005).

[97] See IMF, "Fiscal policy and income" (footnote 96).

[98] In J. Stiglitz, *The Price of Inequality: How Today's Divided Society Endangers Our Future* (New York, W.W. Norton and Company, 2012) pp. 273 ff., the author suggests that the top marginal tax rate should be well in excess of 50 per cent and plausibly in excess of 70 per cent; in A.B. Atkinson, in "Inequality: What can be done?" (footnote 94), pp. 179 ff., the author promotes a top marginal tax rate of 65 per cent.

63. **Introducing a wealth tax is another measure States should consider. Against the backdrop of increasing inequality, wealth taxes have recently found new attention[99] and may provide another way for increasing tax revenues while also fostering equality. States should also reassess other forms of taxation of property, including the transfer of assets. Broadening the tax base this way, and by closing loopholes in the tax code, has the benefit of improving both efficiency and equity.**[100]

64. **Furthermore, States should put an emphasis on fighting tax evasion and avoidance.**[101] **Tax loopholes used by wealthy individuals and multinational companies must be closed. Corporate tax minimizing strategies need to be addressed urgently. For this to be sufficiently effective, and in order to avoid detrimental outcomes for States advancing with such efforts, the work in this field, as in others discussed before, needs to be international in its scope.**

65. **Simultaneously, the findings of the report call for consistent public spending policies that ensure full compliance with the human rights obligations of the States. Such policies must first and foremost ensure that the human rights of the poorest and most vulnerable be respected, protected and fulfilled. They also must include decisive steps towards reversing the trend towards increasing inequality within and among States.**

66. **It is of utmost importance that States provide and progressively extend social protection floors, in accordance with the Social Protection Floor Initiative, the ILO Social Protection Floors Recommendation, 2012 (No. 202), and Goal 1.3 of the Sustainable Development Goals.**[102] **This entails at a minimum that "all in need have access to essential health care and to basic income security",**[103] **in particular for socially disadvantaged groups. However, States are under the obligation to work progressively towards the full realization of economic, social and cultural rights, using the maximum of the available resources. Consequently, States must continue further developing and extending their social systems, if resources permit. Cuts in social spending, and particularly social security and unemployment benefits, may only be made in cases of absolute necessity, after the most careful consideration of all alternatives, which may include tax reforms,**[16] **and only if they are duly justified by reference to the totality of the rights provided for in the Covenant in the context of the full use of the State party's maximum available resources (duty of non-retrogression).**[104]

67. **Public spending must be structured in a way that it benefits mostly persons and groups in need. Despite great efforts of many States and the international community, redistributive policies favour all too often the haves rather than the have-nots,**

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[99] See Piketty, *Capital in the Twenty-First Century* (footnote 4).

[100] See F. Cingano, "Trends in income inequality and its impact on economic growth", OECD Social, Employment and Migration Working Papers No. 163 (2014), para. 58.

[101] See the report of the Independent Expert (A/HRC/31/61).

[102] See the report of the Special Rapporteur on extreme poverty and human rights, Philip Alston, in which a thorough analysis of the linkages between social protection and human rights is provided (A/69/297), and Human Rights Council resolution 25/11.

[103] Sec. 4 ILO Social Protection Floors Recommendation, 2012 (No. 202).

[104] See Committee on Economic, Social and Cultural Rights, general comment No. 3, para. 9.

widening the income and wealth gap and making highly inefficient use of financial resources.[105]

4. Other measures

68. **Apart from more direct actions against inequality, States should have a focus on measures with strong medium- and long-term effects. Investment in education and the development of skills should be of highest priority, as it has robust and significant positive impacts on equality of opportunity, social mobility and long-term growth.**[106] **Furthermore, ensuring equal, affordable access to the courts and legal advice and representation, the establishment of low-cost dispute settlement mechanisms, a robust legislation on political parties financing and promoting a pluralistic mass media system, and strong consumer protection mechanisms should be on the agenda.**

69. **Finally, States and the international community should explore further avenues for reforming parts of their legal systems that appear to have a tendency towards unduly favouring capital owners and the wealthy.**[107] **Making adjustments to existing structures might be an efficient way for achieving necessary change without facing a similar degree of resistance than introducing, for example, new taxes.**

5. Crisis response

70. **It cannot be stressed too often that any response to financial crises, in particular sovereign debt crises, must fully comply with human rights law. In her report, the former Independent Expert on human rights and extreme poverty, Magdalena Sepúlveda Carmona, has already provided very detailed recommendations for such human rights compliant crises responses.**[107] **This report therefore focuses on highlighting only very few important aspects of relevance in the context of inequalities and financial crises. Fiscal stability and GDP may not be the sole targets of adjustment and may not overrule, suspend or dilute existing human rights obligations and responsibilities. Preserving economic, social and cultural rights, including the right to work social security, health, housing and education must be ensured.**[108] **Socioeconomic inequalities must be fully taken into account when implementing crises response measures. While certain spending cuts may be temporarily necessary, the States concerned must always respect the boundaries set by the duty of non-retrogression. They must ensure, to the extent possible, that social spending is affected last and the least. Rather, the States concerned should strongly focus on finding and creating progressive ways of increasing revenues. The protection of vulnerable groups must have the highest priority, calling, for example, for exemptions from cuts or even the implementation of new social protection programmes. The recent experiences of Iceland evidence that this approach is realistic and can yield fruitful results.**[109]

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[105] See A. Nieto Ramos, *El efecto de las pensiones sobre la desigualdad de ingresos en Colombia* (Bogotá, Universidad de los Andes, 2014). See also "Política fiscal y derechos humanos en las Américas" (footnote 16), p. 21.

[106] See S-I. Hsu, "The rise and rise of the one per cent: considering legal causes of wealth inequality", *Emory Law Journal Online*, vol. 64, pp. 2043-2072 (2015).

[107] See A/HRC/17/34.

[108] See the end-of-mission statement of the Independent Expert of his mission to Greece, December 8 2015, available from www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=16852&LangID=E.

[109] See the report of the Independent Expert on his mission to Iceland (A/HRC/28/59/Add.1).

71. **Crises responses, including any agreements between creditors and debtor States should comply with the principles of transparency, accountability and participation. Structural adjustment measures should be subjected to robust human rights impact assessments, both before the implementation and at regular intervals after. Both, creditors and debtors must honour their human rights obligations and responsibilities in their response to debt crises. This may include agreeing on sufficient debt relief in order to avert human rights violations and an exacerbation of inequality.**